1ST FARM CREDIT SERVICES
YOUR FIRST CHOICE

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June 18, 2014

Mr. Barry F. Mardock
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Re: Proposed Rule – RIN 3052-AC44
Standards of Conduct and Referral of Known or Suspected Criminal Violations

Dear Mr. Mardock:

On behalf of 1st Farm Credit Services, thank you for the opportunity to respond to the Farm Credit Administration's proposed rule, published in the *Federal Register* on February 2, 2014, on Standards of Conduct and Referral of Known or Suspected Criminal Violations.

1st Farm Credit Services fully supports and agrees with the comments submitted on this matter by the Farm Credit Council and urges the Farm Credit Administration ("FCA" or "Agency") to adopt the Farm Credit Council's position. In addition to the comments provided by the Farm Credit Council, we urge FCA to consider the following comments.

General Comments

1st Farm Credit Services supports the concept of robust ethical standards for our association, as well as our directors and employees. The clients we serve in agriculture and rural America deserve the highest level of integrity in exchange for the trust they place in us. The current Standards of Conduct regulations provide a sufficient framework for assuring our association conducts business in an ethical manner and that conflicts of interest are appropriately monitored, reported and remedied. If violations occur, the regulations provide ample flexibility for FCA to work with the System institution to address any concerns or implement corrective actions. The current Standards of Conduct regulations far exceed requirements imposed by other financial regulators. Rather than adopting the proposal under consideration, we suggest FCA address Standards of Conduct compliance through ongoing education, both for directors and employees and for Standards of Conduct officials. We therefore request FCA to withdraw this proposal. If the proposal is not withdrawn, we offer a series of suggested changes to reduce the compliance burden on System directors and institutions.

Specific Comments

In the following sections, we outline specific concerns relating to various sections of the proposed regulation:

Code of Ethics – Section 612.2165

Like other Farm Credit System ("System") institutions, including all of the System banks, several years ago 1st Farm Credit Services voluntarily adopted a Code of Ethics to supplement

the requirements of FCA's existing Standards of Conduct regulations. We believe that the System as a whole, including 1st Farm Credit Services, has evidenced a strong commitment to ethical conduct and the avoidance of conflicts of interest. In light of this demonstrated commitment to ethical business practices and the relatively minimal Standards of Conduct violations throughout the System, we encourage FCA to reconsider whether the proposed regulation's excessively technical and administratively burdensome approach to preventing conflicts of interest is truly warranted. The technical review, monitoring and record-keeping necessary under this section far outweigh any transparency achieved for the organization, especially as this section applies to the expanded definition of agents.

Burden on Directors

Our association's safety and soundness ultimately depends on the quality of our directors. As a cooperative with directors primarily elected from among our farmer-owners, we must balance the need to avoid conflicts of interest with the need to attract and retain qualified and experienced directors. By definition, qualified directors with experience in farming and agriculture typically have deep and extensive ties to the agricultural and rural communities served by our association. Because agricultural and rural communities tend to be small and close-knit, a director who operates a farming operation may not have the luxury of simply declining to do business with borrowers or agents. There may be no other practical or economical competitors with whom the director can choose to do business. For example, a director with a cash grain farm may have no practical choice except to sell his or her grain to a local grain elevator, which may also borrow from the association. We therefore feel that the proposed regulation imposes undue practical burdens on directors and may discourage talented and experienced farmers from agreeing to serve on our board. We therefore urge FCA to consider the following:

1. FCA should limit the scope of proposed Section 612.2145(a)(7) to transactions in which the director knows of a potential conflict of interest, thereby making it easier for directors to avoid inadvertent, technical violations. In our association, directors are not involved in day-to-day operational or lending decisions, and as a result are seldom aware they are transacting business with another borrower or association employee. FCA should clearly state that directors have no affirmative duty to investigate the lending relationships of their vendors, service providers, or extended family members, and that directors need not disclose transactions where they have no actual knowledge of a transaction with an applicant, borrower, employee, or agent of our association. For many farmers and local business owners, such inquiries will be viewed as intrusive and could damage the reputation of the director or the association by creating the impression the director has control or influence over the borrower or agent's relationship with the association. The burden of this investigation far outweighs the benefit of unearthing transactions with such low probability of conflict.

2. Section 612.2140(c) is unduly burdensome in that it requires directors to report any "relationship, transaction, or activity that ***may*** violate the institutions' Code of Ethics… or ***could*** constitute a conflict of interest." A strict reading of this language forces absurd results. For example, if a director visits a local farmer's market to purchase tomatoes, the purchase "may" violate the institution's Code of Ethics if the produce stand owner is an association client and the tomatoes were purchased at a discount late in the day (i.e., below fair market value) because the

stand owner wanted to clear out inventory before it spoiled. Read literally, this proposed language requires the director to report and receive a ruling on this transaction in advance from the Standards of Conduct official. This imposes an unworkable burden on directors and the association.

3. To minimize disruption to our directors' farming operations, we encourage FCA to (1) permit directors to disclose material transactions to the Standards of Conduct Official ("SOCO") within a reasonable time after occurrence, rather than requiring prior disclosure and approval, and (2) permit an institution's SOCO to ratify transactions with no material conflict of interest and/or to cure any actual or perceived conflict of interest with appropriate corrective action. This approach accomplishes FCA's goals of preventing conflicts and mitigates the operational disruption to our directors. This approach also minimizes the potential for inadvertent, technical violations of the regulation that do not ultimately present a serious or irreparable conflict of interest.

4. We request FCA to clarify that a transaction in the ordinary course of business, for fair market value or at a price that is generally available to the public, is never "material" for purposes of the regulation and does not require disclosure. This will provide certainty to directors and director candidates who might otherwise worry that serving on our board will disrupt their farming operation.

Administrative Burden

We join the Farm Credit Council in noting that no other federal financial regulator imposes such a burdensome, technical, disclosure-based Standards of Conduct process on its regulated entities. Because the System has a demonstrated history of ethical behavior, we are puzzled by FCA's proposal to subject System institutions to a uniquely intrusive and burdensome regulation.

Based on the size and complexity of our association's operations, we anticipate that the current proposal will require us to hire at least one new, full-time employee to assist with Standards of Conduct administration to handle the added paperwork and investigatory due diligence required. The additional expenses, estimated to be at least $100,000 annually over our existing Standards of Conduct compliance costs, will reduce our efficiency, safety and soundness and could undermine our ability to provide dependable and cost-effective credit to agriculture and rural America. We ask FCA to consider the following changes to minimize the administrative burden imposed by the proposed regulation:

1. We support defining the term "family" in a broadly inclusive way. However, the phrase "anyone whose association or relationship with the director or employee is the equivalent of the foregoing" is ambiguous and creates regulatory uncertainty. We request FCA reduce this uncertainty by defining the term "family" to include only legally-recognized relationships, such as civil unions, non-traditional marriages or adoptions. Without this change, the SOCO might be required to ask directors and employees personally intrusive questions in order to ascertain whether or not a relationship is subjectively "equivalent" to a traditional family relationship. In the worst case scenario, such questions could subject the association to legal liability based on a claim that we discriminated against a protected class, either by a SOCO's determination that a particular relationship is not "equivalent" to a family relationship or merely because we were

required by FCA to acquire knowledge of an employee's personal relationships, potentially in conflict with other federal laws.

2. Standards of Conduct officials should be independent and responsible for impartially making Standards of Conduct determinations. We are concerned that this responsibility has not been paired with the authority and independence necessary to permit the SOCO to serve his or her intended purpose.

For example, Section 612.2145(b)(4)(iii)(B) requires the Standards of Conduct Official to "adequately" demonstrate that a particular transaction is in the ordinary course of business or is not material, but does not define the term "adequate" or provide any guidance that would permit the Standards of Conduct Official to know with certainty that he or she has made a correct decision. Subsections (B) and (C) should be revised to remove the term "adequately demonstrate" and replace with "document" to reduce this ambiguity and provide a workable standard for Standards of Conduct officials. Similarly, Section 612.2165(c)(1) appears to provide System institutions with the ability to make case-by-case exceptions to certain aspects of the regulations, but conditions this exception on a written determination by the SOCO that there is no possible "appearance of a conflict of interest." This inherently subjective determination is subject to second-guessing from FCA examiners. The phrase "to avoid the appearance of a conflict of interest" should be removed from this section.

Further, the proposed regulation purports to give System institutions flexibility to set a *de minimis* threshold for material transactions. However, the *de minimis* amount must be "so insignificant that no reasonable person could conclude that it would influence a director or employee's ability to act impartially and in the best interests of the System institution." This highly exacting yet subjective standard means SOCO's will be extremely reluctant to rely on it. System boards of directors should have full responsibility to set a *de minimis* level, without FCA imposing an unreasonable standard for the decision.

Finally, Section 612.2165(f) permits FCA to ignore any and all guidance found in the regulations and to unilaterally determine "that a particular financial interest or transaction, relationship, or activity constitutes a conflict of interest or the appearance of a conflict of interest." This provision renders meaningless the entire regulation and ensures that, in practice, SOCO's will be unwilling to apply common sense to their decisions for fear of being overruled by FCA in hindsight. This language exposes System institutions to inconsistency in examination staff interpretations of the regulations. We strongly disagree with this language and recommend that it be removed from the proposed regulation.

Absent removal of the objectionable language in these sections, as an alternative to mitigate these concerns, we urge FCA to adopt a "safe harbor," analogous to the advice-of-counsel defense available in certain legal situations, that would protect the SOCO, the affected directors, employees, or agents, and the institution itself from regulatory or enforcement actions where the SOCO makes a reasonable and good faith decision and the institution acts consistently with that decision.

3. To reduce the time burden on SOCOs, FCA should clarify that they may reasonably rely on representations by persons with knowledge of the facts surrounding a transaction and are not under an affirmative duty to personally verify these facts or to investigate matters (such as the rate of interest that might be customary or "market" in light of a client's particular credit request, repayment ability, and offered collateral) that will likely be beyond the professional competence of the Standards of Conduct official.

4. Section 612.2160(a)(3) of the proposed regulation would require us to "immediately" notify FCA of "suspected material" violations involving criminal conduct, director or employee separation, or adverse impact on public confidence in the System. The current standard requiring an institution to "report promptly" should remain. FCA should endorse prompt and appropriate due diligence, including a fact investigation, prior to notifying the Agency of a violation. The duty to "immediately" notify FCA of suspected violations will require FCA staff to waste substantial time and energy responding prematurely to situations where no violation occurred. Further, this requirement may undermine the association's safety and soundness by mandating us to prematurely document concerns, thereby creating discoverable records that are inaccurate and based on an incomplete understanding of the facts. Such records could nevertheless be used by a litigant to support a frivolous lawsuit arising out of the transaction. In light of this potential and the proposed obligations under Sections 612.2170(a)(7) and 612.2170(a)(8), we ask FCA to consider Standards of Conduct documents and information submitted to FCA privileged and exempt from disclosure under the Freedom of Information Act. We also point out that some courts have held documents created pursuant to a legal or regulatory obligation are not always protected by the attorney-client privilege, even when prepared by an attorney. *See, e.g.*, *United States ex rel. Barko v. Halliburton Co.*, 1:05-CV-1276, 2014 WL 1016784 (D.D.C. Mar. 6, 2014). We encourage FCA to clarify that a System institution is not required to take any action, refrain from taking any action, or create any document or record when, on the advice of legal counsel, the institution believes doing so might impair its legal privileges or rights.

5. As noted above, we agree Standards of Conduct Officials should have the authority and independence necessary to impartially make Standards of Conduct determinations. Professionals such as attorneys, independent auditors, and Human Resources professionals often possess the necessary knowledge, authority and independence, even though they are not officers of the institution. We urge FCA to adopt a standard similar to the standard set out in 12 C.F.R. § 611.210, which defines a "financial expert" as "one recognized as having education or experience in" the relevant issues. Using this standard, the Standards of Conduct official could be any officer of the institution or any other employee who is recognized as having the education or experience necessary to impartially administer the institution's Standards of Conduct program.

6. In light of the fact that no other federal financial regulator has imposed similar standards of conduct regulations on its regulated industry, we request FCA to clarify how we may determine the "applicable industry approved best practices for standards of conduct" under Section 612.2160. Farm Credit institutions are privately-owned financial cooperatives with a separate regulatory framework. Given our unique structure, there are no similar standards within an "applicable industry" against which we may compare ourselves, other than to other Farm Credit institutions.

7. Sections 612.2145 and 612.2155 would require the SOCO to annually renew certain determinations, even if no facts have changed surrounding the relationship or transaction. This requirement substantially increases the administrative burden imposed by the proposed regulation without providing any commensurate benefit to the association. If no facts have changed, no annual review should be required. We ask that this provision be removed.

9. Section 612.2165 requires the Standard of Conduct Official to review all official loans before they are submitted to the institution's supervisory bank for approval. This obligation imposes tremendous administrative burdens and introduces a redundant layer of review that wastes association resources and further delays approval of official loans, even where no conflict of interest exists. We believe that this obligation duplicates the supervisory bank's responsibilities without providing benefit to the System. We request that FCA delete this provision.

Agents

We request FCA to exclude agents and other consultants from the proposed Standards of Conduct regulation. The requirements of this regulation, and the definition of an "agent," are overbroad and unworkable. For example, a title insurance agent that conducts a real estate closing and concurrently issues a title insurance policy is often technically acting as a "closing agent" for the association. It is unreasonable to expect us to ask each and every title agent with whom we do business to sign the Code of Ethics and agree to be bound by the burdensome obligations of the proposed regulation. Similarly, the Administrative Agent under a syndicated credit agreement is technically an agent of the association. It is extremely unlikely that a representative of a global bank acting as the Administrative Agent of a syndicated loan would be willing to certify that the bank will comply with our Code of Ethics and Standards of Conduct policy, including the prohibition on purchasing acquired real estate under Section 612.2180 of the proposed regulation. These new provisions will curtail or foreclose ongoing and future business relationships necessary to serve our clients and fulfill our mission.

Section 612.2160 would require us to "ensure compliance…by...agents" and Section 612.2180(b) makes System institutions "responsible for the actions of their agents." These provisions would massively expand our legal liability to third parties, and we believe FCA may not have considered or intended this result. The expansive definition of "agent" is much broader than a traditional agency relationship under common law. The absolute obligation to ensure compliance, avoid the "appearance of" conflicts of interest, and assume responsibility for the actions of our agents is unreasonable and unworkable. We cannot practically or legally exercise absolute control over the actions of the appraisers, consultants, title insurance companies, banks, and other professionals and counterparties we work with and should not be responsible for these parties' actions. These sections should be revised to impose only the obligation to take commercially reasonable measures, including conducting appropriate due diligence.

If FCA insists on this provision, those subject to industry or professional ethical standards should not have to certify they will adhere to the Code of Ethics, and such agents should not be provided with a copy of the standards of conduct policy and Code of Ethics. This provision would impose an unwarranted administrative burden, and create the risk of technical and inadvertent violations of the proposed regulation.

If this provision remains in the final regulation, we ask FCA to clarify that System institutions are not required to ask all existing agents to immediately sign the Code of Ethics on the effective date of the new regulation. We should be permitted to "grandfather" existing agents or only obtain a new signature at the time the agent's contract renews.

Overall, we strongly object to FCA's inflexible and uniform approach to agents. A marketing consulting who assists with a marketing slogan does not present the same potential for conflicts of interest as a real estate broker who markets acquired property for the institution. A System institution should not be forced to undertake the same level of effort to prevent conflicts of interest with respect to both types of "agents." Similarly, a publicly-traded, multi-national company that negotiates for and acquires information technology assets on behalf of, or provides information technology consulting to, a Farm Credit System institution might arguably be classified as an "agent" under the proposed regulation. If FCA requires large and sophisticated companies to certify that they (and, presumably, all of their subsidiaries and perhaps thousands of employees) will abide by the System institution's Code of Ethics, these companies will simply refuse to do business with the Farm Credit System. For these reasons, FCA should provide Farm Credit System institutions the flexibility to make reasonable, risk-based determinations regarding the potential for conflicts of interest in transactions with agents and should permit the Standards of Conduct official to waive the requirement that an agent certify to the Code of Ethics in appropriate circumstances.

Other Guidance

We join the Farm Credit Council in concluding the phrase "and guidance" in Section 612.2135 is inappropriate. Further, we note that Section 612.2165(f) permits FCA to ignore exceptions found in the regulations and to unilaterally determine during the examination process "that a particular financial interest or transaction, relationship, or activity constitutes a conflict of interest or the appearance of a conflict of interest." These provisions are overbroad and likely violate the Administrative Procedures Act. We encourage FCA to remove this language from the final rules.

Conclusion

Today's Standards of Conduct regulations sufficiently provide the framework needed to ensure overall safety and soundness as to the conduct of directors and employees. The current regulations also provide FCA adequate authority to address any violations by an individual or System institution. The burdensome, costly, and materially restrictive regulations proposed greatly exceed those in place by other federal financial regulators. The proposed regulations excessive disclosure requirements will harm System institutions by limiting their ability to attract the highest quality and most successful farmers to serve as directors. For the reasons described herein, we request that FCA withdraw this proposal or materially revise many of the specific provisions that are both counter-productive and unduly burdensome. 1st Farm Credit Services shares FCA's desire to avoid conflicts of interest within the Farm Credit System, but we are concerned that these proposed regulatory changes will reduce our ability to attract qualified directors and have a negative financial impact our business to the detriment of our client-owners.

We encourage FCA to withdraw or revise the proposal in light of these comments, as well as the Farm Credit Council's comments, so that the Farm Credit System may continue to operate

efficiently and remain financially sound for the benefit of our stockholders. We appreciate the opportunity to provide input on this proposed regulation. If you have any questions about our association's position, please contact me.

Respectfully submitted,

Barbara Kay Stille
Executive Vice President – Operations & General Counsel
1st Farm Credit Services

CC: Board of Directors
Gary Ash, CEO